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C O N F I D E N T I A L SECTION 01 OF 03 QUITO 002462

SIPDIS

STATE PASS TO USTR BENNETT HARMAN

E.O. 12958: DECL: 09/10/2014

TAGS: [EPET](#) [ETRD](#) [ECON](#) [EC](#)

SUBJECT: OXY: GOE TAKES A SERIOUS WRONG TURN

REF: A. QUITO 2418

[1B](#). QUITO 2380

[1C](#). QUITO 2327

Classified By: Ambassador Kristie A. Kenney Reason 1.4 (b), (d)

[11](#). (U) See action request in paragraph 12.

[12](#). (C) Summary. The GOE is proceeding with the contract nullification process (caducidad) against Occidental Petroleum (Oxy), potentially triggering the nationalization of Oxy's assets in Ecuador. Presidential Legal Advisor Carlos Larrea acknowledged that the GOE action would amount to an expropriation, expressly prohibited by the Ecuadorian Constitution. Still, he said President Gutierrez was too weak to negotiate a resolution with Oxy. The GOE has grossly underestimated the strong negative reaction from the USG and the foreign investor community should the GOE follow through with the nullification. We have spoken with Oxy's GM and are educating GOE officials about the severity of its miscalculation. These efforts appear to bearing fruit as Gutierrez has apparently ordered Economy and Finance Minister Yepez to meet with Oxy on September 10 to explain that the Larrea position is not the GOE's official position. We urge State, USTR and Commerce officials to send a similar message to Ecuador's Ambassador to the United States and other GOE officials. End Summary.

GOE to Pursue Contract Nullification/Nationalization

[14](#). (C) In a September 8 meeting with econoffs, Presidential Legal Advisor Carlos Larrea said the GOE would go forward with the nullification of Oxy's Block 15 contract (reftels), essentially nationalizing Oxy's Block 15 assets. Econ Counselor explained to Larrea the serious nature of such action, comparing it to the expropriations of the 1970s. He told Larrea that it could cost Ecuador its ATPDEA trade benefits and a free trade agreement with the United States. Larrea said he was aware of those risks. He felt Oxy would be able to overturn the expropriation in local courts as the Ecuadorian Constitution prohibited expropriations, but said President Gutierrez was too weak politically to resolve the case through negotiation. He suggested that after the administrative nullification, judicial action would be the only remedy left to Oxy.

[15](#). (U) Later that day, Minister of Energy and Mines (MEM) Eduardo Lopez announced in a press conference that he would seek the nullification of the Oxy contract. The actual nullification and takeover of Oxy's Block 15 assets could occur within the next 30-70 days.

Embassy Action

[16](#). (C) Ambassador met with Oxy Ecuador President and GM Jerry Ellis on September 9, who said that Oxy had not received the official notification of intent to nullify from the MEM. He added that if the MEM declared nullification of the contract, Oxy would not seek relief in any Ecuadorian legal process, but seek a remedy through the Bilateral Investment Treaty (BIT) and/or the U.S. courts. Ellis feared what could happen to Oxy's assets if they were left to Petroecuador to run for even a short period of time. He was reluctant to characterize the GOE's action thus far as retaliation, but said Oxy would consider the takeover of its Block 15 assets nothing short of expropriation. Still, he said Oxy was willing to sit down with the GOE to discuss a mutually beneficial resolution to the matter.

[17](#). (C) He agreed with the Ambassador's recommendation that she contact President Gutierrez again about the issue. The Ambassador also explained the she had raised the matter with the President of Congress that morning and he too admitted that it appeared that the GOE was trying to nationalize Oxy's assets. Econoffs also explained the MEM's latest step in the nullification process to USTR on the morning of September 9 as USTR was preparing for a meeting between Ambassador Zoellick and Trade Minister Bak. Our efforts appear to be bearing fruit. Late September 9, Ellis told Econ Counselor

that President Gutierrez had ordered Economy and Finance Minister Yepez to meet with Oxy in New York on September 10, and to tell Oxy that the policy espoused by Presidential Legal Advisor Carlos Larrea was not the GOE policy.
The Oxy Nullification Case as a Political Landmine

¶8. (C) The Procurador has put the Gutierrez government in an extremely difficult position with his actions on the Occidental case. The press and public have swallowed, hook, line and sinker, the Procurador's oft-repeated public line that Oxy has violated the terms of its contract, that the Minister of Energy is legally bound to nullify the contract, and that that process should be expedited. The Procurador stated a week ago to the press that anyone opposing his involvement in the case was "a traitor to the fatherland" - clearly an attempt to create a political climate in which the government would have no choice but to expropriate Oxy's property. On September 6, he announced that if the Ministry of Energy and the state oil company did not move expeditiously he would request that the Controlaria (an investigatory body analogous to our GAO, but with the authority to bring charges against government officials for malfeasance) open investigations. Less than 24 hours later the Minister of Energy acted.

¶9. (SBU) The effect of the Procurador's tactics has been wide and deep. Opinions expressed in the press and on the street are almost unanimous: "the GOE must nullify the Oxy contract, anything less would be a breach of rule of law."

¶10. (C) Our contacts universally believe that the Procurador is acting with the support of the Guayaquil-based Social Christian Party (PSC, by its Spanish acronym) in order to place the Gutierrez government in a position in which it must choose against a position that the whole country has equated with basic Ecuadorian national interests or against the United States. Many believe that this trap has been laid in order to bring the government down. Presidential Legal Advisor Larrea told us that top PSC insiders such as Miguel Orellana and Javier Neira, but maybe not party leader Leon Febres Cordero, were behind the Procurador's actions. Consulate General officers in Guayaquil will continue to make clear to PSC officials our support for constitutional democracy as well our expectations of a level playing field for US companies.

Comment and Action Request

¶11. (C) A strong message must be sent to the GOE that if it follows through with the nullification it could amount to expropriation of an American company's assets. Should an expropriation occur, Ecuador would risk losing its ATPDEA trade benefits, a possible free trade agreement with the United States and the support of the international community, both investors and multilateral lenders. The Ambassador will again explain to President Gutierrez the potential serious consequences of this latest misstep by the GOE and Embassy officials will continue to raise the matter with their GOE counterparts.

¶12. (C) Action Request. We recommend State and Commerce raise with Ecuador's Ambassador to the United States Raul Gangotena and other high-ranking GOE officials our serious concern about the possible expropriation of an American company's assets. We suggest the following talking points:

-- The action by the Procurador was taken on the heels of Oxy's international arbitration award, making it appear to be a case of retaliation.

-- Regardless of whether the GOE or Oxy are right on the merits of the case, the remedy sought by the GOE is not proportionate to the alleged offense and could amount to an expropriation, an unconstitutional act in Ecuador, and an act penalized under U.S. law.

-- It is in everyone's interest for both sides to sit down and discuss a reasonable solution to this matter.

-- If Oxy's assets are expropriated, Ecuador risks losing ATPDEA trade benefits, a free trade agreement with the United States and the support of the international community, both private investors and multilateral lenders, not to mention the certain ruin of its investment climate.

KENNEY